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Stephen E. Shay
Deputy Assistant Secretary for International
Tax Affairs
United States Department of the Treasury
1500 Pennsylvania Ave, NW
Washington, DC 20220
stephen.shay@do.treas.gov

Steven A. Musher
Internal Revenue Service
Office of the Associate Chief Counsel (Int'l)
1111 Constitution Avenue, NW
Washington, DC 20224
steven.a.musher@irs.counsel.treas.gov

Manal Corwin
International Tax Counsel
United States Department of the Treasury
1500 Pennsylvania Ave, NW
Washington, DC 20220
manal.corwin@do.treas.gov

Michael Danilack
Deputy Commissioner (Int'l) LMSB
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224
michael.danilack@irs.gov

RE: SIFMA Comments on Notice 2010-60

Ladies and Gentlemen,

The Securities Industry and Financial Markets Association (“SIFMA”)¹ welcomes the opportunity to submit the following comments in response to Notice 2010-60 (the “Notice”), regarding the regulations that are being developed to implement the provisions of the Foreign Account Tax Compliance Act (“FATCA”) that were included in section 501 of the recently enacted Hiring Incentives to Restore Employment Act (the “HIRE Act”).

The FATCA provisions impose a 30 percent withholding tax, which operates separately from the U.S. nonresident withholding tax imposed under

¹ SIFMA brings together the shared interests of securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

sections 1441 and 1442.² In general, the FATCA withholding tax applies to “withholdable payments” made to a foreign financial institution (an “FFI”), unless the FFI enters into an agreement with the IRS (an “FFI agreement”) to comply with various information reporting and withholding requirements with respect to “U.S. accounts.” For this purpose, “FFI” is broadly defined to include foreign banks, brokers, and investment funds, including private equity and hedge funds as well as securitization vehicles.³ “Withholdable payments” include U.S. source dividends, interest (including original issue discount), and other “fixed or determinable annual or periodical” income, as well as any gross proceeds from the sale or other disposition of property that can produce U.S. source interest or dividends.⁴ “U.S. accounts” generally include depository accounts, custodial accounts, and non-regularly-traded equity or debt interests in an FFI held by a “specified U.S. person” or a “U.S. owned foreign entity.”⁵ FATCA also imposes related information reporting and withholding requirements in respect of payments made to non-financial foreign entities (“NFFEs”).⁶ In its discussion of FATCA, the Notice identifies another class of entity, U.S. financial institutions (“USFIs”) that will be impacted by FATCA, primarily in their role as withholding agents.

The information reporting and withholding obligations under FATCA are different for FFIs and NFFEs. To escape withholding, an FFI must have in place an FFI agreement with the IRS, under which it agrees to identify which of its financial accounts are U.S. accounts, report annually on those accounts to the IRS,

² Unless otherwise indicated, all section references herein are to sections of the Internal Revenue of 1986, as amended (the “Code”).

³ See section 1471(d)(4) & (5); Joint Committee on Taxation Technical Explanation of the Revenue Provisions Contained in the HIRE Act, JCX-4-10 (the “JCT Explanation”), at 44 (“Accordingly, the term financial institution may include among other entities, investment vehicles such as hedge funds and private equity funds.”).

⁴ See section 1473(1).

⁵ See section 1471(d)(1).

⁶ See section 1472.

and withhold on “passthru payments” (withholdable payments made by an FFI and other payments made by an FFI that are attributable to withholdable payments received by the FFI) to account holders that refuse to identify themselves (“recalcitrant account holders”), and eventually to close such accounts.⁷ An FFI must also withhold on passthru payments made to another FFI unless the other institution is itself FATCA compliant (a “participating FFI”).⁸ Alternatively, an FFI can comply with FATCA by establishing that it does not have any U.S. accounts or accounts held by noncompliant FFIs. An NFFE can avoid withholding on withholdable payments by certifying to the withholding agent that the NFFE does not have U.S. direct or indirect owners (subject to some minimum ownership thresholds) or by identifying those owners. The principal goal of FATCA is to identify and disclose to the IRS information regarding U.S. taxpayers who have been evading their tax responsibilities by investing through FFIs and NFFEs in situations where information returns in respect of such U.S. investors have not been required to be filed.

SIFMA shares the objectives of FATCA in improving offshore tax compliance. SIFMA also welcomes many of the approaches to the FATCA regulations that are outlined in the Notice. In the remainder of this letter, SIFMA comments on the following topics in response to the Notice, in order to assist the Department of the Treasury and the IRS in crafting regulations that are effective in accomplishing FATCA’s goals without unnecessarily disrupting the operations of the financial markets:⁹

⁷ See sections 1471(b)(1)(D) and 1471(d)(7).

⁸ See section 1471(b)(1)(D).

⁹ On August 11, 2010, SIFMA submitted comments regarding various aspects of the FATCA regulations, in response to Announcement 2010-22 and Announcement 2010-34. Certain of these comments were with regard to topics that are not addressed in the Notice, and SIFMA presumes that they will be considered in due course. Certain other comments were with regard to topics that are addressed in the Notice, and certain aspects of those comments are repeated in this letter where appropriate.

- (1) *Transition Rules.* Technical recommendations regarding the transition rules for preexisting accounts.
- (2) *Identification and Documentation Procedures.* Technical recommendations regarding the procedures to be used by participating FFIs and USFIs to distinguish between various categories of payees and account holders.
- (3) *Election To Be Withheld Upon.* Technical recommendations regarding the procedures to be applied for a participating FFI that elects to be withheld upon. An FFI should only be permitted to make this election with the prior written consent of the withholding agent.
- (4) *Passthru Payment Definition.* A payment should only be treated as a passthru payment if it is passed on in a custodial capacity, made by a partnership or disregarded entity, or directly contractually attributable to an underlying withholdable payment.
- (5) *Sanctions for FFIs with Many Recalcitrant Account Holders.* The determination as to whether a participating FFI with a significant number of recalcitrant accounts is considered noncompliant should be based on an analysis of all of the facts and circumstances.
- (6) *Simplified Reporting.* In addition to the default FATCA reporting mechanism and the full Form 1099 reporting option, participating FFIs should be permitted to elect a simplified Form 1099 reporting regime that does not require reporting of cost basis.

- (7) *Special CFC and U.S. Branch Procedures.* Special compliance procedures should be provided for CFCs and U.S. branches of FFIs.
- (8) *FFI Agreement Procedures.* Technical recommendations regarding practical aspects of the FFI Agreement.
- (9) *Securitization Vehicles.* Existing securitization vehicles should be treated as exempt from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B).
- (10) *Grandfather Rule for Existing Obligations.* The grandfather rule for existing obligations should apply to transactions executed after March 18, 2012, but for which all of the substantial terms of the legal agreement governing the transaction are fixed on or before such date.
- (11) *Retirement Plans.* The definition of retirement plan provided in the Notice should be expanded.
- (12) *Foreign Estates.* It should be confirmed that the definition of FFI does not include foreign estates.

Comment 1: Transition Rules

SIFMA appreciates the efforts that the Department of the Treasury and the IRS have made to ease compliance burdens through the adoption of transition rules applicable to preexisting accounts of both participating FFIs and USFIs.¹⁰ SIFMA believes that the proposed rules are generally workable, but would make the following suggestions to improve them further:

¹⁰ See Sections III.B.2.a., III.B.3.a., and III.C.1. of the Notice.

- (i) In analyzing a preexisting account under the transition rules, the Notice requires both participating FFIs and USFIs to review electronically searchable information associated with the account. To conform with the terminology and procedures prevalent in the securities industry, SIFMA would suggest that the information required to be searched be limited, for both participating FFIs and USFIs, to static client data (e.g., names, mailing addresses, residence information, etc.) that is associated with an account in the records of the participating FFI or USFI, and not in the records of any affiliate of the participating FFI or USFI, at the point in time of the review. This would include, for example, client data stored on the applicable administrative system (e.g., an account database) used in processing transactions or payments for an account.

- (ii) The transition rules provide for various periods during which FATCA requirements are relaxed for preexisting accounts. In the case of a participating FFI, such periods generally begin with the effective date of its FFI agreement. The requirements of FATCA, however, do not generally come into effect until January 1, 2013. As a consequence, the transition rules would discriminate against FFIs that enter into FFI agreements prior to that date, since the earlier effective dates of their FFI agreements would result in shorter transition periods. As a consequence, FFIs would be disincentivized to enter into FFI agreements before January 1, 2013, which would not be in the interest of the IRS. To eliminate this disincentive, which would serve no useful purpose, SIFMA would suggest that, at least for purposes of the transition rules, any FFI agreement entered into prior to January 1, 2013, be deemed to have an effective date of January 1, 2013. Treating the effective date of such FFI

agreements as January 1, 2013, will also help to harmonize the transition rules applicable to participating FFIs with the transition rules applicable to USFIs, which generally have transition periods that begin on January 1, 2013.

- (iii) The transition rules for preexisting entity accounts of a participating FFI provide that, if an entity account holder tentatively classified as an FFI does not provide a valid FFI EIN and certification of participating FFI status within 9 months after the participating FFI's FFI agreement enters into effect, the participating FFI must, within 1 year after such effective date, request other required documentation from the entity. The 9 month period appears to serve no useful purpose, and SIFMA would accordingly suggest that it be eliminated. Under the simplified rule, a participating FFI would simply need to either obtain a valid FFI EIN from an entity account holder or request the other required documentation from the entity account holder within 1 year after such effective date.

- (iv) The transition rules for preexisting entity accounts of both participating FFIs and USFIs appear to require that, for a preexisting entity account holder that documentation on file indicates is an NFFE, the participating FFI or USFI must generally obtain documentary evidence that specifically identifies each individual, and each other specified U.S. person, that has an interest in such entity.¹¹ In the case of an NFFE, however, FATCA generally only requires identification of each substantial United States owner.¹² SIFMA would suggest that

¹¹ See Sections III.B.3.a.(4)(c) and III.C.1.(3)(c) of the Notice.

¹² See sections 1471(b)(1)(B) and 1473(2)(A).

the noted transition rules be clarified to confirm that only identification of substantial United States owners is required in this situation.

- (v) The transition rules for preexisting individual accounts of a participating FFI provide that, in certain cases, the participating FFI must request certain documentation within 1 year of the effective date of its FFI agreement, and then classify the account holder as a recalcitrant account holder if the documentation is not provided within 1 year of the date of the request.¹³ SIFMA believes that requiring participating FFIs to monitor the dates on which they request documentation will be costly and burdensome, and will not serve any purpose (and may indeed induce participating FFIs to delay making any such requests until the latest possible date, which would be counterproductive). SIFMA would accordingly suggest that the noted transition rule be simplified to require the participating FFI to classify the account holder as a recalcitrant account holder if the required documentation is not provided within 2 years of the effective date of its FFI agreement.
- (vi) The transition rules for preexisting individual accounts of a participating FFI provide that an account holder may be treated as exempt from FATCA if all depository accounts held by the account holder at such FFI have an aggregate value of less than \$50,000 during the calendar year preceding the effective date of the FFI's FFI agreement.¹⁴ The size of such accounts must in some cases be retested 5 years after the

¹³ See Section III.B.2.a.(5) of the Notice.

¹⁴ See Section III.B.2.a.(1) of the Notice.

effective date of the FFI agreement, however, and the Notice further indicates that the size of such accounts may be required to be retested prior to 5 years after such date. In order to reduce the compliance burdens associated with such smaller accounts, SIFMA would suggest that retesting not be required prior to 5 years after such date.

- (vii) The transition rules for preexisting individual accounts of a participating FFI provide that such accounts will be subject to the rules applicable to new accounts 5 years after the effective date of the FFI's FFI agreement, unless the participating FFI has collected, reviewed, and maintained documentary evidence sufficient to establish the U.S. or non-U.S. status of such accounts, and such U.S. or non-U.S. status is reflected in electronically searchable information maintained by the FFI and associated with the account. SIFMA would suggest that this rule be clarified to confirm that a Form W-8 will be treated as sufficient documentary evidence for this purpose. In addition, SIFMA would suggest that appropriate KYC or AML information obtained under currently existing procedures also be confirmed to constitute sufficient documentary evidence for this purpose.

Comment 2: Identification and Documentation Procedures

FATCA requires both participating FFIs and USFIs to distinguish between numerous categories of payees and account holders. In various places, the Notice requests comments regarding appropriate procedures for making such determinations, in particular with respect to various exemptions (e.g., from FFI

status) provided in the Notice.¹⁵ SIFMA has the following suggestions regarding such identification procedures:

- (i) In appropriate cases, SIFMA believes that FFIs and USFIs should be permitted to identify payees and account holders for FATCA purposes on the basis of documentation maintained at other FFIs and USFIs. In this regard, Treasury regulations section 1.1441-1(e)(4)(ix)(C) currently allows a withholding agent to rely on the certification of a U.S. broker that the broker holds a valid beneficial owner withholding certificate, and Private Letter Ruling 200107027 (Nov. 20, 1999) currently allows a U.S. securities clearing broker dealer to rely on a beneficial owner withholding certificate maintained by a FINRA-registered introducing securities broker, without the need for any further action or inquiry. These rules are relied on today by a wide variety of withholding agents, particularly securities clearing organizations. In many cases, the withholding agents that rely on documentation maintained by others do not have the systems capacity to collect the information themselves, and it would be a substantial burden for them to build such systems solely for FATCA purposes. SIFMA would accordingly recommend that reliance procedures similar to those currently available for nonresident

¹⁵ *See, e.g.*, Section II.B.1 of the Notice (“Treasury and the IRS request comments as to how the classes of entities discussed above [certain holding companies, start-up companies, liquidating or reorganizing NFFEs, and hedging/financing centers] may be more specifically defined in regulations, what mechanisms withholding agents could use to properly identify such entities (including self-certification, as appropriate) and whether other classes of entities should be similarly excluded.”); Section III.B.3.a of the Notice (“Treasury and the IRS request comments about the level of evidence that should be sufficient to establish under step 4(a) that an entity is engaged in an active trade or business”); Section III.C.2 of the Notice (“Treasury and the IRS request comments regarding appropriate procedures for identifying participating FFIs, deemed-compliant FFIs, non-participating FFIs, entities described in section 1471(f), excepted NFFEs, and other NFFEs from among new account holders of USFIs.”).

withholding purposes be carried over into the FATCA regulations, with the limitation that the documentation must be maintained by either a USFI or a participating FFI to be relied upon. Under such procedures, a USFI or participating FFI should be permitted to rely on documentation maintained by another USFI or participating FFI, for all types of accounts introduced by such a USFI or participating FFI, and for all FATCA identification, information reporting, and withholding purposes, and such reliance should not require any further action or inquiry. SIFMA notes that such procedures would be consistent with the general approach adopted in the Notice for chains of accounts, under which only the participating FFI that has the most direct relationship with the investor or customer is required to perform FATCA information reporting.¹⁶

- (ii) In some cases, SIFMA believes that the only practical way for a participating FFI or USFI to reliably identify an entity as falling within a particular category would be to obtain, and rely upon, a written certification from that entity. This would in particular be true for identifying an entity as being a holding company, a start-up company, a liquidating or reorganizing NFFE, or a hedging/financing center.
- (iii) In other cases, it may be possible for a participating FFI or USFI to reliably identify an entity as falling within a particular category by using an “eyeball” test, in some cases in reliance on KYC or AML information. SIFMA believes, for example, that KYC or AML information may be reliably used to identify whether an entity is engaged in an active trade or business in

¹⁶ See Section IV.E. of the Notice.

some cases. SIFMA anticipates submitting additional comments on this topic in the future.

- (iv) Regardless of the availability of an eyeball test in appropriate circumstances, however, a participating FFI or USFI should always be permitted to identify an entity as falling within a particular category by obtaining and relying upon a written certification from the entity, unless the participating FFI or USFI knows or has reason to know that the certification is incorrect or unreliable. In order to enhance the reliability of such a certification, however, it may be appropriate in some cases to require that it be accompanied by a supplemental, reasonably detailed explanation for why the entity falls within a particular category.
- (v) To facilitate the use of written certifications, the Department of the Treasury and the IRS should consider assigning EINs with unique prefixes to each category of entity that is relevant under FATCA (e.g., participating FFIs, exempt retirement plans, etc.), and requiring such EINs to be given on applicable certification forms. Again, this would be consistent with the successful implementation of the qualified intermediary, withholding foreign partnership, and withholding foreign trust regimes, under which EINs with unique prefixes, such as 98-023XXXX and 98-024XXXX, were issued.
- (vi) If a participating FFI or USFI is not able to promptly identify an account holder as being a participating FFI or otherwise exempt, payments to the account holder may be subject to FATCA withholding. Because there are frequently delays in obtaining documentation for new accounts, however, SIFMA would suggest that all new accounts be given a documentation

grace period of 90 days. Under this rule, any FATCA withholding tax in respect of a new, undocumented account would be retained by the participating FFI or USFI for 90 days, and could be refunded to the account holder if appropriate documentation is provided within such 90-day period. After the lapse of the 90-day period, the withholding tax would be remitted to the IRS. Alternatively, the withholding agent could deposit the FATCA withholding tax with the IRS, and if refunded to the account holder, could reduce future deposits by the amount refunded, as presently allowed under the refund procedures under section 1461.

- (vii) To the extent that there is a delay between the time that an FFI applies for participating FFI status and the time that such status is granted, SIFMA would suggest that an applicant FFI be permitted to certify that it is a participating FFI until such time as its application is rejected. Further, a participating FFI or USFI should be permitted to rely on such a certification from an applicant FFI unless the withholding agent or FFI knows or has reason to know that the certification is incorrect or unreliable.

Comment 3: Election To Be Withheld Upon

FATCA allows a participating FFI to elect to be withheld upon rather than to itself comply with the FATCA withholding requirements in certain circumstances.¹⁷ In its prior comment letter, SIFMA noted that it may not be practical in all cases for a participating FFI to exercise the election to be withheld upon, in part because the withholding agent making withholdable payments to the electing FFI (either a USFI or another participating FFI) may not have sufficient

¹⁷ See section 1471(b)(3).

information regarding the transactions giving rise to the withholding obligation. As a consequence of this, and other factors, SIFMA suggested that the regulations clearly specify how such an election would work and what effect it would have, and further recommended that the election be permitted only with the prior written agreement of the withholding agent.

The Notice does not provide specific rules regarding the election to be withheld upon, and instead requests further comments regarding (i) the appropriate scope of such an election, including the types of financial accounts for which such an election should be available; and (ii) the type of information reporting an electing FFI would need to provide to a withholding agent.¹⁸

In order to make the elective withholding regime practical and administrable for both electing FFIs and withholding agents, SIFMA would suggest that the rules implementing the regime be structured in accordance with the following guidelines:

- (i) Consistent with SIFMA's prior comments, a participating FFI should be allowed to elect to be withheld upon only with the prior written agreement of the withholding agent.
- (ii) The elective withholding regime should function on a pooled basis. Under such a system, the electing FFI would essentially communicate withholding instructions to the withholding agent, including the portion of each type of payment, or the portion of the total payments made on a particular payment date, that should be subject to FATCA withholding. The withholding agent would then withhold in accordance with those instructions. SIFMA notes that such an approach would be largely consistent with that adopted for withholding

¹⁸ See Section V.C. of the Notice.

statements provided with Forms W-8IMY, under which similar instructions are furnished by nonqualified intermediaries to U.S. withholding agents. As noted in its prior comments, SIFMA believes that, in many cases, the withholding agent will not have sufficient information regarding the transactions giving rise to the withholding obligation to determine itself the amount of a payment that is subject to withholding; SIFMA further believes that, in many cases, it would not be practical for electing FFIs to provide such information. In addition, withholding on a non-pooled basis would require the electing FFI to disclose information regarding the beneficial owners of the payments, which SIFMA also believes would not be practical for many electing FFIs to do.

- (iii) The electing FFI should continue to be responsible for any information reporting that may be required in respect of the beneficial owners of withholdable payments. This would include both general FATCA account reporting (which is not affected by the election to be withheld upon) as well as necessary reporting to beneficial owners and the IRS regarding amounts withheld under the election (which both account holders and the IRS will want to know). As noted above, SIFMA believes that it would not be practical for an electing FFI to provide to the withholding agent any specific beneficial owner information that may be required for the withholding agent to perform this reporting function. In addition, SIFMA believes that an electing FFI, as the party with the closest relationship to beneficial owners, would be much better placed to perform this reporting function. Finally, since an electing FFI will, in any event, retain the responsibility to perform general FATCA reporting in respect of its U.S. accounts, it should be a nominal,

incremental burden for the FFI to be required to report on amounts withheld under the election.

- (iv) In order for the IRS to be able to verify payment and withholding amounts reported by an electing FFI, however, a withholding agent should be required to provide annual, pooled reporting to the IRS and each electing FFI regarding the total amount of tax that it has withheld on payments to such electing FFI. SIFMA believes that such reporting would be both appropriate and useful and, again, would be wholly consistent with information reporting that is required for payments made by U.S. withholding agents to qualified intermediaries.

Comment 4: Definition of Passthru Payment

FATCA requires an FFI to withhold on passthru payments in certain circumstances.¹⁹ For this purpose, a passthru payment is defined under FACTA as a withholdable payment or other payment to the extent attributable to a withholdable payment.²⁰ Thus, a withholdable payment that is received by an FFI, but beneficially owned and paid on to another person, would result in a passthru payment. These types of payments are common where, for example, a payment on a U.S. security passes through one or more intermediaries before being credited to the account of the beneficial owner. In such a case, because an FFI in the chain is merely passing on a payment to a beneficial owner, it should be able to determine the source and character of the payment, and should accordingly be able to determine how much, if any, to withhold under FATCA. In more complicated situations, however, SIFMA members are very concerned about the meaning and application of the phrase “to the extent attributable to a withholdable payment.” Absent needed clarification, this language could conceivably apply to any payment in respect of a debt or equity

¹⁹ See section 1471(b)(1)(D).

²⁰ See section 1471(d)(7).

interest in an FFI to the extent the FFI derives income from a withholdable payment, regardless of whether such debt or equity interest is actively traded, and regardless of whether such FFI is treated as a pass-through entity.

The Notice requests comments regarding methods that a participating FFI could use to determine whether payments it makes are attributable to withholdable payments, including any associated information reporting that may be necessary, and which take into account the administrative burden imposed by any such approach.²¹ SIFMA strongly believes that, to the extent the term passthru payment is defined to include payments made on debt or equity interests issued by a non-custodial FFI that is not treated as a pass-through entity for U.S. tax purposes, withholding agents will need clear and administrable rules to identify how much of such payments should be attributed to underlying withholdable payments received by the FFI. In many cases, this information may not be readily available or may change with each payment on the relevant securities, which will dramatically increase the compliance burden to the extent such cases are included within the definition.

In order to achieve the intended purpose of the passthru payment rule while minimizing administrative burdens, SIFMA recommends that the regulations provide that a payment will only be treated as attributable to a withholdable payment to the extent that it is (i) made by an FFI acting in a custodial capacity on behalf of an account holder with respect to an underlying withholdable payment; (ii) made by an FFI that is treated as a partnership or disregarded entity for U.S. tax purpose with respect to an underlying withholdable payment; or (iii) made by a non-custodial, non-pass-through-entity FFI and is directly contractually attributable to an underlying withholdable payment (each a “direct passthru payment”). An example of the first category of direct passthru payment would be a dividend on a U.S. stock that an FFI receives in its capacity as a broker, and pays into an account that is maintained by either the broker or another FFI for the benefit of the

²¹ See Section I of the Notice.

shareholder. An example of the second category of direct passthru payment would be a distribution from a private equity investment partnership FFI that contains the proceeds of dividends on U.S. stocks received by the FFI. An example of the third category of direct passthru payment would be a payment of interest on a structured note issued by an FFI, the terms of which provide for the payment of interest equal to the dividends received on certain U.S. stocks held by the FFI.

In accordance with the foregoing definition, payments made by an FFI that are not direct passthru payments as described above should not be included in the definition of passthru payment, even though they may in some indirect sense be attributable to withholdable payments received by the FFI (“indirect passthru payments”). An example of an indirect passthru payment would be an interest payment made on standard, fixed rate debt of a corporate FFI where some portion of the FFI’s general revenues over the interest accrual period consist of dividends on U.S. stocks. Another example would be a payment by a mutual fund FFI in redemption of an interest in the fund, where some portion of the fund’s income during the period in which the interest was outstanding consists of dividends on U.S. stocks.

For a direct passthru payment, SIFMA believes that it should be reasonably possible for the paying FFI or the withholding agent to determine the portion of the payment that is properly attributable to underlying withholdable payments, and to treat that portion as a passthru payment potentially subject to FATCA withholding. On the other hand, for an indirect passthru payment, it would be very difficult or impossible to determine what portion, if any, of the payment is properly attributable to underlying withholdable payments. This will be particularly true in the mutual fund FFI redemption example noted above, where an attempt at attribution could require the FFI to analyze many years of income in the case of each redemption payment that it makes. To the extent that the Department of the Treasury and the IRS are concerned that, e.g., a mutual fund FFI might be structured to effectively pass through withholdable payments to recalcitrant

account holders, the IRS will retain the ability to terminate such an FFI's participating FFI status if it appears that it is acting in an abusive manner.

In implementing the clarified definition of passthru payment proposed above, the regulations will need to provide for the communication of information from an FFI that originates a passthru payment to any other FFIs or other withholding agents that may be responsible for withholding on the payment. In this regard, the Notice states that, where there are multiple participating FFIs in a chain of accounts, only the participating FFI that has the most direct relationship with the investor or customer will be required to perform FATCA information reporting.²² Although not expressly stated in the Notice, SIFMA presumes that the regulations will also place withholding responsibility for passthru payments that are passed along a chain of participating FFIs on the participating FFI that has the most direct relationship with the investor or customer, since only that FFI will be in a position to know if the recipient is a recalcitrant account holder or non-participating FFI that is subject to passthru payment withholding. SIFMA would suggest that the regulations confirm this chain rule, and provide that the originator of a passthru payment be required to provide sufficient information so that any other relevant participating FFI or other withholding agent in a chain of payments can determine the portion of the payment that is a passthru payment subject to FATCA withholding.

In addition to the foregoing, SIFMA would recommend that the definition of passthru payment not include a payment made by an FFI that is attributable to a withholdable payment that is exempt from FATCA requirements. One circumstance in which this clarification would be relevant would be with respect to passthru payments attributable to underlying withholdable payments on obligations that qualify for the FATCA grandfather clause (since the grandfather clause does not itself exclude payments on grandfathered obligations from the

²² See Section IV.E. of the Notice.

withholdable payment definition, and passthru payments in respect of such underlying payments could otherwise be subject to FATCA withholding).

Finally, SIFMA would also suggest that the definition of passthru payment not include payments made by an FFI that is generally exempt from FATCA requirements (e.g., under section 1471(b)(2)(B)), or that are made by other FFIs and that are directly or indirectly attributable to withholdable payments received by the exempt FFI. Otherwise, a payment made by an FFI at the end of a long chain of payments could perhaps be treated as a passthru payment on the basis of a withholdable payment received by an exempt FFI at the start of the chain. Such a rule would be very difficult to administer, and would also substantially reduce the benefit to the exempt FFI of its exemption.

SIFMA recognizes that the passthru payment rule is designed to provide a necessary backup mechanism to prevent evasion of FATCA withholding through multi-step payment streams. Nonetheless, SIFMA urges the Department of the Treasury and the IRS to carefully consider how to adequately clarify the definition of the term passthru payment so that it is practically administrable by withholding agents.

Comment 5: Sanctions for FFIs with Many Recalcitrant Account Holders

The Notice requests comments regarding what measures should be taken to address long-term recalcitrant accounts, including whether, and in what circumstances, the Department of the Treasury and the IRS should consider terminating FFI agreements due to the number of recalcitrant account holders remaining after a reasonable period of time.²³

SIFMA would make the following suggestions regarding participating FFIs with many long-term recalcitrant accounts:

²³ See Section V.D. of the Notice.

- (i) The determination as to whether a participating FFI with a significant number of recalcitrant accounts is considered noncompliant (and thus at risk of losing its participating FFI status) should not be based on a perfunctory test (e.g., a test based on the mere proportion of recalcitrant accounts).
- (ii) Instead, the determination should be based on an analysis of all of the facts and circumstances. The goal of this analysis should be the identification of participating FFIs that are not making reasonable, good faith efforts to comply with the terms of their FFI agreements, as opposed to participating FFIs that inadvertently have significant numbers of recalcitrant accounts despite good faith efforts to comply.
- (iii) In evaluating whether a participating FFI with a significant number of recalcitrant accounts is noncompliant, and in determining the consequences of such noncompliance, SIFMA believes that the situation should be viewed in context, and that the compliance efforts of other participating FFIs in the expanded affiliated group should be both taken into account and respected. One result should be that, if the proportion of recalcitrant accounts of all of the participating FFIs in an expanded affiliated group viewed together is not large, the number of recalcitrant accounts in any particular FFI should not itself be relevant. Viewing a group in this way will allow groups to centralize their handling of recalcitrant accounts, which will allow for more efficient management of such accounts, including with respect to withholding and account termination efforts. In addition, however, if for whatever reason a particular FFI is found to be noncompliant after a full evaluation of the facts and circumstances, but other

participating FFIs in the group do not themselves show similar indicia of noncompliance, the noncompliant FFI should not taint other participating FFIs in the group and subject them to potential punitive measures.²⁴ This will prevent mistakes that arise in a particular subsidiary from improperly affecting other subsidiaries with more robust compliance practices.

- (iv) If a participating FFI with a significant number of recalcitrant accounts is identified as noncompliant, it should be given a reasonable period of time (e.g., 90 days) to cure any compliance failures before any punitive measures are imposed (such as having its FFI agreement terminated). SIFMA notes that such an approach would be consistent with the Notice and Cure provisions contained in Section 11.05 of the Qualified Intermediary Agreement, under which a qualified intermediary that experiences an event of default may cure such event within a prescribed period of time.

- (vi) In order to avoid possible market disruption that may be caused by unanticipated punitive withholding, any termination of an FFI agreement should apply strictly on a prospective basis.

Comment 6: Simplified Reporting

FATCA requires a participating FFI to report gross receipts and gross withdrawals and payments in respect of certain U.S. accounts, except to the extent provided otherwise by the Department of the Treasury,²⁵ unless the FFI elects to do

²⁴ See section 1471(b)(1) (flush text) (providing only that an FFI agreement “may be terminated . . . upon a determination . . . that *the foreign financial institution* is out of compliance with such agreement”) (emphasis added).

²⁵ See section 1471(c)(1)(D).

full Form 1099 reporting.²⁶ The Notice request comments as to how to minimize burdens on participating FFIs with respect to such reporting.²⁷

SIFMA believes that the Department of the Treasury should utilize its authority to provide exceptions to the two noted reporting regimes in a manner that reduces the burdens on participating FFIs while still maintaining an adequate flow of information to the IRS. In particular, SIFMA would suggest that the regulations give participating FFIs the option of providing simplified Form 1099 reporting that contains more information than the default reporting regime, but less than full Form 1099 reporting would require. In this regard, SIFMA believes that the requirement to report cost basis under the full Form 1099 reporting regime, which is quite involved and costly to implement, will strongly deter FFIs from adopting that reporting regime. An alternative, simplified Form 1099 reporting regime that does not require reporting of cost basis, on the other hand, would be much more palatable to FFIs.

SIFMA would be pleased to work with the Department of the Treasury and the IRS to develop a process for simplified Form 1099 reporting. As noted, SIFMA contemplates that such simplified Form 1099 reporting would at a minimum not require reporting of cost basis, which would obviate the need for an FFI to implement the costly systems necessary to track that information. In addition, however, SIFMA believes that there are other items of non-cash tax information that could be appropriately excluded from such simplified Form 1099 reporting without adversely affecting the IRS's ability to police tax compliance. Examples of such non-cash tax items that may be unnecessary include accruals of original issue discount on long-term obligations, other items of imputed income, amounts of foreign tax withheld, deducted investment expenses, adjusted issue price, market discount information on REMICs and CDOs, and supplemental information on widely held

²⁶ See section 1471(c)(2).

²⁷ See Section IV.C. of the Notice.

fixed income trusts. SIFMA believes that simplified Form 1099 reporting would not significantly impair the government's ability to combat offshore tax evasion, and that the simplified Form 1099 information would indeed be substantially more useful to the IRS than the information that it would receive under the default reporting regime.

Comment 7: Special CFC and U.S. Branch Procedures

In its prior comment letter, SIFMA suggested that controlled foreign corporations ("CFCs") and U.S. branches of FFIs, which are currently subject to full Form 1099 reporting requirements as U.S. payors, should be treated as exempt from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B). The creation of such an exemption is directly supported by the FATCA legislative history, which recognized that U.S. payors already are subject to extensive reporting requirements.²⁸ The Notice, however, did not adopt this suggestion, explaining that the documentation and reporting requirements to which U.S. payors are currently subject are less stringent than those that apply to FFIs. Although the observation in the Notice may have some validity, SIFMA would nonetheless urge the Department of the Treasury and the IRS to consider whether there may be a middle ground.

The FFI definition is extraordinarily broad, and there are accordingly a great many entities that could need to enter into FFI agreements with the IRS. In order to reduce the compliance burdens of entering into such agreements, for market participants and the IRS, SIFMA continues to believe that it would be beneficial to create a special procedure for CFCs that does not require the signature

²⁸ See JCT Explanation at 41 ("Additionally, the Secretary may identify classes of institutions that are deemed to meet the requirements of this provision if such institutions are subject to similar due diligence and reporting requirements under other provisions in the Code. Such institutions may include certain controlled foreign corporations owned by U.S. financial institutions and certain U.S. branches of foreign financial institutions that are treated as U.S. payors under present law.")

of a full FFI agreement. Such a procedure would be particularly helpful for groups with large numbers of CFCs.²⁹

SIFMA would accordingly continue to suggest that certain CFCs be treated as exempt from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B). In order to address the concern expressed in the Notice that CFCs are subject to less stringent documentation requirements than FFIs, SIFMA would suggest that the exemption be limited to CFCs for which a certification is made that they will perform Form 1099 reporting under sections 6041, 6042, 6045, and 6049 in accordance with the requirements of section 1471(c)(2)(B) (i.e., under the rules applicable to FFIs that elect to do full Form 1099 reporting, treating each holder of an account that is a specified United States person or United States owned foreign entity as if it were a natural person and citizen of the United States, and accordingly not eligible for treatment as an exempt recipient).³⁰ SIFMA believes that this modification to a CFC's normal Form 1099 reporting duties would address the concern expressed in the Notice, while still preserving substantial administrative benefits. In this regard, one way for a CFC that meets the above requirements to certify to the IRS that it is in compliance would be for the U.S. owner of the CFC to check a box making the certification on the Form 5471 filed for the CFC each year.

Along similar lines, and in order to provide a level playing field as between, e.g., U.S. banks and U.S. branches of foreign banks, SIFMA would also suggest that, under the FFI agreement applicable to a U.S. branch of an FFI, the U.S. branch be permitted to elect to be subject to the same rules that are applicable to USFIs.

²⁹ Unless, of course, the Department of the Treasury and the IRS adopt the suggestion in Comment 8, below.

³⁰ In order to preserve a level playing field, however, such a CFC should also have the option of performing enhanced Form 1099 reporting in accordance with the simplified Form 1099 reporting procedure suggested in Comment 6, above, to the extent this suggestion is adopted.

Comment 8: FFI Agreement Procedures

The Notice indicates that the Department of the Treasury and the IRS intend to publish a draft FFI agreement in future guidance.³¹ One practical aspect of the FFI agreement that SIFMA would suggest be considered is how to implement it for expanded affiliated groups, especially groups with multiple FFIs in different jurisdictions. In order to minimize compliance burdens for such a group, as well as for the IRS, SIFMA would suggest that a group sign a single FFI agreement with a schedule listing the individual FFIs that are subject to the agreement. In order to include any necessary special rules for group members in particular jurisdictions or with special statuses, SIFMA would then suggest that the main FFI agreement provide for the inclusion of standardized annexes, as in the case of the KYC Attachment under the existing qualified intermediary regime. In this regard, SIFMA believes that a very large number of FFIs will need to sign agreements, and that adopting a group agreement concept with appropriate annexes to cover any special circumstances will be very helpful in streamlining the process of getting agreements into place.

Comment 9: Securitization Vehicles

FATCA gives the Department of the Treasury and the IRS clear authority to exempt certain FFIs from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B).³² Utilizing this authority, the Notice provides a number of exclusions from the definition of FFI, which SIFMA fully supports. The Notice also requests comments, however, regarding other specific classes of foreign entities that should be: (i) excluded from the definition of FFI; (ii) deemed to meet the requirements of section 1471(b)

³¹ See Preamble of the Notice.

³² See section 1471(b)(2) (“A foreign financial institution may be treated by the Secretary as meeting the requirements of this subsection if . . . (B) such institution is a member of a class of institutions with respect to which the Secretary has determined that the application of this section is not necessary to carry out the purposes of this section.”).

pursuant to section 1471(b)(2); or (iii) identified as posing a low risk of tax evasion pursuant to section 1471(f).³³ As noted in its prior comments, one class of foreign entity that SIFMA believes should be excluded from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B) is the class of existing securitization vehicles.

A “securitization vehicle” is an entity that issues equity and/or debt securities, the payments on which are primarily funded by the cash flows from a discrete pool of financial assets acquired by the vehicle with the proceeds of a fixed amount of initial contributions.³⁴ Non-U.S. securitization vehicles have invested hundreds of billions of dollars in the U.S. economy, particularly in loans issued by small and mid-sized U.S. companies. In the absence of an exemption, a typical non-U.S. securitization vehicle that holds U.S. assets and issues its own securities would generally be treated as an FFI. Unfortunately, it is quite likely that many existing securitization vehicles would be unable to enter into and comply with the requirements of an FFI agreement. This could lead to significant disruptions in the U.S. debt markets.

In a typical securitization vehicle transaction, all aspects of the securitization vehicle’s activities are governed by a detailed trust indenture. The indenture specifies everything from the required features of the securitization vehicle’s assets to the making of payments to trustees and other service providers. In many cases, the indenture will both allow and require the securitization vehicle to acquire new assets over the course of its existence. As a practical matter, amendments to a securitization vehicle indenture are very difficult, as they require the consent of substantial supermajorities of affected investors.

³³ See Section II.E of the Notice.

³⁴ Cf. section 743(f) (defining a “securitization partnership” as a partnership “the sole business activity of which is to issue securities which provide for a fixed principal (or similar) amount and which are primarily serviced by the cash flows of a discrete pool (either fixed or revolving) of receivables or other financial assets that by their terms convert into cash in a finite period, but only if the sponsor of the pool reasonably believes that the receivables and other financial assets comprising the pool are not acquired so as to be disposed of”).

The trust indentures for existing securitization vehicles predate FATCA and, accordingly, do not authorize or require any party on behalf of the securitization vehicle to perform the actions required of FFIs. The trust indentures also do not provide a means of paying for such activities. Although in theory it might be possible for the trust indenture of an existing securitization vehicle to be amended by a vote of the investors to permit the vehicle to enter into and comply with an FFI agreement, no party is likely to be designated to initiate such an amendment process, and there can be no guarantee that investors would agree to the required changes. In addition, it may be impossible for an existing securitization vehicle to require holders of outstanding debt and equity interests to comply with applicable identification and documentation requirements that were not contemplated at the time the trust indenture was executed and the securities were issued. Furthermore, in the event that an existing securitization vehicle subjected investors to withholding under an FFI agreement, the trust indenture could allow or require the vehicle to be terminated, since withholding of this type was not anticipated. The termination of these vehicles could lead to U.S.-issued securities being disgorged into the secondary market, flooding the market with assets and depressing the prices of such securities. Finally, even for securitization vehicles created after the enactment of FATCA, it will be very difficult to draft appropriate trust indenture provisions before the regulations implementing FATCA are issued in final form and it is clear what the vehicles must do.

Although it is true that the FATCA grandfather clause will exempt from withholding all debt obligations outstanding as of March 18, 2012,³⁵ the grandfather clause alone will not be enough to help existing securitization vehicles, for a number of reasons. First, existing securitization vehicles have already invested in U.S.-issued debt that may be amended after March 18, 2012, and the Notice provides that such debt would lose the protection of the grandfather clause if the amendment is classified as a deemed reissuance under Treasury regulations section

³⁵ See section 501(d)(2) of the HIRE Act.

1.1001-3.³⁶ Second, existing securitization vehicle indentures generally prohibit investing in new assets that would be subject to a withholding tax (and for which no exemption is available), which would effectively preclude existing securitization vehicles from investing in debt originated after March 18, 2012.³⁷ Third, existing securitization vehicles have invested in revolving and other debt under which draws will be made after March 18, 2012, and could become subject to the withholding tax on this basis.³⁸ In this regard, the trust indentures for some securitization vehicles could allow or require the vehicles to be terminated in the event such a withholding tax were imposed, since withholding of this type was not anticipated.

The issues discussed above that would prevent an existing securitization vehicle from complying with the FFI information reporting and withholding provisions of FATCA would also prevent an existing securitization vehicle from complying with the NFFE certification requirements, in particular because the vehicle would generally not be able to identify the indirect owners of its securities traded in the secondary market.

Finally, SIFMA believes that existing securitization vehicles pose little risk of facilitating tax evasion by U.S. persons. The investors in securitization vehicle securities are predominantly U.S. and non-U.S. banks, insurance companies, and other institutional investors, rather than the U.S. individual investors that are the primary target of FATCA. Moreover, interests in securitization vehicles are mainly held through U.S. financial institutions and FFIs that SIFMA anticipates will be participating FFIs. As such, the interests in such vehicles should not escape reporting.

³⁶ See Section I of the Notice.

³⁷ See *CLO Interest*, Moody's Investors Service, pg. 8 (May 2010) (noting this prohibition and the consequences that may result due to its interaction with FATCA).

³⁸ See also the discussion below under Comment 10.

Based on the foregoing, SIFMA would again suggest that securitization vehicles in existence on the date that the FATCA regulations are issued in final form be treated as exempt from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B). For securitization vehicles created after the date that the regulations are issued in final form, no special exemptions or other provisions should be necessary, as such vehicles should generally be able to build the necessary ability to comply with FATCA into their trust indentures from the beginning.

Comment 10: Grandfather Rule for Existing Obligations

FATCA withholding will generally apply to withholdable payments made after December 31, 2012,³⁹ except that withholding is generally not required for payments in respect of obligations outstanding on March 18, 2012.⁴⁰ The term “obligation” is not defined, and is in particular not expressly limited to debt instruments. The Notice clarifies that, for purposes of the grandfather clause, an obligation will be defined to include any legal agreement that produces or could produce withholdable payments, so long as it is not treated as equity for U.S. tax purposes, or lacks a definitive expiration or term. This proposed definition of obligation is very similar to the one proposed in SIFMA’s prior comments, and SIFMA believes it is sensible.

SIFMA would also suggest, however, that the regulations confirm that, so long as all of the substantial terms of a legal agreement governing a non-equity transaction are fixed on or before March 18, 2012, and the transaction has a definitive expiration or term, the transaction will be treated as within the grandfather clause notwithstanding that it may be executed after such date. In this regard, there are many situations where all of the substantial terms of a legal agreement governing a transaction may be fixed before the transaction is executed.

³⁹ See section 501(d)(1) of the HIRE Act.

⁴⁰ See section 501(d)(2) of the HIRE Act.

Examples include simple term loans (where a loan agreement may be signed, or a commitment letter entered into, days or months before the loan proceeds are advanced), syndicated loan facilities (which are designed to provide for periodic issuances of term loans, revolving loans, letters of credit, and other instruments over a term of typically 5-10 years), repos under Master Repurchase Agreements (which are designed to provide for periodic repos of securities under a standard framework agreement), securities loans under Master Securities Lending Agreements (which are designed to provide for periodic securities loans under a standard framework agreement), and notional principal contracts under ISDA Master Agreements (which are designed to provide for periodic notional principal contracts under a standard framework agreement). For this purpose, SIFMA would suggest that the substantial terms of a legal agreement governing a transaction should be defined as (i) the definitive expiration or term of the transaction; and (ii) the amount, or a fixed, objective formula for calculating the amount, of each payment to be made under the transaction.

In addition, SIFMA would suggest that “payments in respect of” an obligation be defined to include any payments paid by reference to an obligation.⁴¹ In particular, where the obligation in question is a loan, “payments in respect of” the obligation should include both payments of interest and principal, as well as commitment fees, facility fees, amendment fees, and other common types of compensation typically paid to lenders in respect of loans.

Comment 11: Retirement Plans

FATCA provides that withholding under section 1471(a) does not apply to any payment to the extent that the beneficial owner of such payment is part of a class of persons identified by the Department of the Treasury as posing a low risk of tax evasion.⁴² Utilizing this authority, the Notice provides an exemption for

⁴¹ Cf. Treasury regulations section 1.892-3T(a)(1)(i) (providing an exemption under section 892 for “income from” investments in the United States in stocks, bonds, or other securities).

⁴² See section 1471(f).

“retirement plans,” which the Notice defines as a plan that “(i) qualifies as a retirement plan under the law of the country in which it is established, (ii) is sponsored by a foreign employer, and (iii) does not allow U.S. participants or beneficiaries other than employees that worked for the foreign employer in the country in which such retirement plan is established during the period in which benefits accrued.”⁴³ The Notice also requests comments regarding this definition.

SIFMA fully supports the exemption for retirement plans, which is similar to an exemption that SIFMA suggested in its prior comments. SIFMA believes, however, that the proposed definition is too narrow. In particular, SIFMA is concerned that it would be unworkable for many multinational groups, which may have certain unified retirement plans for employees located in multiple jurisdictions. In addition, the application of the proposed definition to collective investment vehicles maintained by multiple retirement plans (which are an increasingly common way in which retirement plans invest their assets) is unclear.

As an alternative, SIFMA would suggest that a retirement plan be defined for purposes of the exemption as a corporation, partnership, trust, other entity, contractual arrangement, or pool of assets that is operated principally either (i) to administer or provide pension or retirement benefits; or (ii) to earn income for the benefit of one or more entities, arrangements, or pools described in clause (i).⁴⁴ As such, the exemption would extend both to non-U.S. retirement plans as well as to collective investment vehicles or arrangements created among non-U.S. retirement plans.

⁴³ See Section II.C. of the Notice.

⁴⁴ Cf. Paragraph 1(k) of Article 3 of the United States Model Tax Convention on Income (2006) (defining “pension fund” similarly for treaty purposes, including various exemptions from withholding tax).

Comment 12: Foreign Estates

In some cases, a non-U.S. estate may be treated as a separate entity or legal person under non-U.S. law, and may conduct investment activities for many years pending resolution. SIFMA does not believe, however, that such a non-U.S. estate was intended to be included in the definition of FFI, as such an estate would not be in the “business” of accepting deposits, holding assets, or investing or trading.⁴⁵ To eliminate confusion, it would be helpful if the regulations could clarify that, to the extent a non-U.S. estate is treated as an entity, it is not treated as an FFI. In addition, it would be helpful if the regulations could clarify under what circumstances a non-U.S. estate will be treated as an entity (and therefore an NFFE) for purposes of FATCA.

* * *

SIFMA appreciates your consideration of its collective views and concerns on the regulations that are being developed to implement the provisions of FATCA. Please do not hesitate to contact me at (202) 962-7333 or emccarthy@sifma.org if you have any questions or if we can be of further assistance.

Sincerely,



N. Ellen McCarthy
Managing Director, Government Affairs
Securities Industry and Financial Markets Association

Cc: Jesse Eggert, Attorney Advisor, Office of International Tax Counsel, Department of Treasury
Itai Greenberg, Attorney Advisor, Office of International Tax Counsel, Department of Treasury

⁴⁵ See section 1471(d)(5).

Michael Plowgian, Attorney Advisor, Office of International Tax Counsel,
Department of Treasury
John Sweeney, Office of Associate Chief Counsel, Internal Revenue Service